

**MONTANA SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS**

**Comments and Observations on the  
Administration of Montana Tax Law**

Developed by:

**The State Taxation Committee  
And  
Legislative and Governmental Affairs Committee**

Submitted to:

**Honorable Brian Schweitzer  
Governor of the State of Montana  
State Capitol  
Helena, MT 59620**

**Dan Bucks, Director  
Montana Department of Revenue  
PO Box 5805  
Helena, MT 59604-5805**

**Revenue and Transportation Interim Committee**

## **Comments and Observations on the Current Administration of Montana Tax Law**

The Montana Department of Revenue has made numerous changes in the administration of Montana's statutes and rules regarding taxes since January, 2005. The following represents some but not all of the thoughts, issues and comments Montana CPAs have regarding the changes that have occurred.

When we have the opportunity to work directly with the capable and conscientious people who staff the Department of Revenue, we are typically able to resolve issues in a manner that is fair to the state and the taxpayer. We appreciate their professionalism.

### **EXECUTIVE SUMMARY**

The Montana Society of Certified Public Accountants (MSCPA) has long enjoyed a good working relationship with the Montana Department of Revenue (DOR) and we have a successful history of working together in the development and implementation of good tax policy. CPAs are on the front line in dealing with the "tax gap". The relationship of the CPA with his/her clients allows them to determine proper reporting of income and expense. The result is taxpayers often think CPAs work for the government but CPAs are charged with the duty to collect the correct tax – a duty they take very seriously.

The MSCPA received daily phone calls and emails from CPAs across the state, during tax season, with concerns and problems regarding the DOR. Calls and emails continue even now on at least a weekly basis. The comments address areas such as:

- ✓ taxpayer service;
- ✓ communications received from DOR;
- ✓ problems with forms;
- ✓ general tax policy changes and interpretations, and
- ✓ trust.

We are particularly concerned with the comments regarding a new, negative attitude of unwillingness by DOR administration to work with Montana taxpayers to settle inquiries, disputes and delinquent accounts.

Our members are hearing from their clients – taxpayers who are DOR's customers. Many of the problems could be avoided or reduced with better communications to the taxpaying public and to the tax preparers who represent them.

The following general and specific comments detail the calls and emails we have received from Montana CPAs over the recent months.

### **GENERAL AND SPECIFIC COMMENTS**

#### **Communications with Taxpayers**

Montana taxpayers who have filed electronically are receiving notices that changes have been made to their returns including the amount of tax due. The notices are usually for increases in taxes for the taxpayer because of problems with DOR's e-filing system. The electronic file DOR receives from the

IRS does not contain the complete Montana tax return as e-filed by the taxpayer. Credit for items such as the endowment credit and the elderly credit are showing up on the hard copy tax form prepared by the Montana CPA, however, the form e-filed by the tax preparer is not what DOR receives from the IRS.

Tax returns for corporations, S corporations, partnerships, LLPs, LLCs and trusts cannot be filed electronically with the State of Montana. We understand it is a priority of DOR to enable electronic filing of non-individual tax returns. We share DOR's sense of urgency and sincerely hope we can be a part of that process.

DOR does not always contact the tax preparer when the taxpayer has initialed the preparer contact box on the tax return. If a taxpayer has marked this box on their return then DOR should be contacting the tax preparer directly – we cannot emphasize this enough. Contacting the preparers when the box is checked would eliminate a lot of time, expense and confusion. The advantage to doing so is a reduced number of error notices and other correspondence from DOR which in turn leads to increased processing efficiencies and less cost to DOR and, ultimately, the taxpayers.

DOR has increased the number of extra disclosures requested from taxpayers. The extra disclosures are a concern to taxpayers who get confused and tax preparers who incur additional time to fulfill these requests. The increased information has resulted in many unnecessary mistakes and changes in returns.

We'd like to hold up a particularly grievous example of poor communications: A Montana taxpayer was selected for an audit by the DOR and after an initial informational meeting, documents were provided to a DOR auditor. Without any notification to the taxpayer a report was issued disallowing all the expenses in question for five years. As it turns out, the initial auditor (no longer with the DOR) was replaced by the auditor assigned as the trainer of the first auditor. No documentation was requested for four of the five years. In spite of the fact that the report was appealed, the taxpayer was billed for the tax due on the initial report. Making matters worse, the DOR forwarded the initial report to the IRS in error and this resulted in an audit report for the Internal Revenue Service that mirrored the DOR report. This is a situation where an honest taxpayer made an honest mistake and is doing everything in his power to fix it. This has caused more than unnecessary stress and bad feelings towards the DOR. This taxpayer is so distraught over the situation that he is experiencing health problems as a result. We are sad to say this is not an isolated case.

### **Communications with Tax Preparers**

The MSCPA has offered repeatedly to help with statewide communication efforts. We have not heard any response to our offers. In previous administrations, MSCPA received an article from the Director's office that was published in every issue of our newsletter. In the last 30 months this form of communication to our members has ceased to exist.

We have been able to identify one notice in DOR's e-newsletter, Rev-a-News, that contained information concerning the 1099G issue. DOR staff informed MSCPA that the public has been notified of the change. However, not every Montanan receives this electronic publication. If this was the only notice sent about the 1099G issue, then many people didn't receive the message. Furthermore, DOR did not notify the tax software vendors of the change and the only way a change can be implemented to the software is through official departmental notification.

DOR worked extensively with the title and REALTOR groups to amend the Realty Transfer Certificate. We applaud those efforts. However, DOR did not inform MSCPA of the availability of the new

brochure that was a result of these meetings; a brochure that educates real estate buyers of their tax obligation for sales in Montana. This would have been a wonderful opportunity for the MSCPA to help DOR educate taxpayers through our member CPAs. We were able to get a copy from the title group which we then distributed to our membership both electronically and in hard copy.

The MSCPA and DOR met many times during the last interim to discuss DOR's legislative agenda yet we were still surprised by the legislation actually introduced. We counted at least 25 bills drafted at the request of DOR in the 2007 session. We believe this is a record number and draws attention to DOR's singular focus on legislation. Unfortunately the copies of the bills we received came through a third party and not the DOR. We feel this lack of communication indicates a problem.

We have learned of many administrative changes via complaints from our members. We learned of legislation and other actions by DOR through third parties on several occasions. Communication between DOR and MSCPA has broken down and is not direct and therefore not effective.

### **Forms**

The redesigned forms are much longer and more confusing to the public than previous versions. The number of line items that a taxpayer or tax preparer has to review makes the form hard to follow and difficult to understand.

Changes to forms and filing requirements by DOR have been made without input from the CPAs or other interested parties. While we respect that DOR has complete authority to make these changes it would make sense to gather input from the professionals on the front line who will be implementing these changes.

We consider the discontinuation of the amended return forms 2X and CLT4-X to have major deficiencies. DOR, taxpayers and tax preparers would all be better served if the forms were continued. The IRS continues to use amended returns, DOR should as well. At the very least, the problem with the new reporting method – reconciliation and instructions that do not clearly and accurately foot to the amended refund or amount due – should be fixed.

The 1099G form for reporting state tax refunds is creating nothing but confusion for taxpayers, tax preparers and DOR. We understand how the issue surfaced, however, most Montana taxpayers are finding it very difficult to understand how they have a taxable refund when they never received a refund check from the State of Montana in the first place. What complicates the issue even more is that many Montana taxpayers will over report their Montana refund on their Federal return.

The review of 100% of returns claiming the endowment credit is understandable in it's infancy but to continue to perform their review each year is a questionable benefit.

DOR is performing a 1099 NEC match-up program similar to the IRS CP-2000 match-up program. Although this could be an effective compliance program for DOR, it fails when the state is not capturing the Schedule C from an electronically filed tax return. How can the state match up 1099 NEC information when it does not capture Schedule C?

DOR has invoked a requirement that the taxpayer include a signed copy of the Federal Form 1120. We feel this request is redundant and unnecessary. The taxpayer signature on the Montana form CLT-4 already covers and addresses attachments.

### **Tax Policy**

We have concerns about legislation regarding penalties and interest, such as HB 592 from the 2005 session. Several items of contention have surfaced as a result of the new software program IRIS. While IRIS is a better program than POINTS, issues have resulted from the new software including the 1099G problem, the amended return problem and the elderly interest/tax exempt interest exclusion.

A serious concern results from the DOR sending collection letters before all payments were posted. Payments were received by the DOR and not processed before the assessments were mailed.

We strongly feel that the key to greater tax compliance is tax simplification. The more complicated Montana tax law becomes the harder it is to comply and to encourage compliance. The average Montanan now needs a CPA or other high level tax preparer to protect themselves from onerous penalties and interest. Tax simplification is a goal that we strongly support on the behalf of Montana taxpayers and it's an issue we would gladly work with DOR to achieve.

### **Trust**

The trust the MSCPA has had with DOR for decades has been severely strained. The past 30 months have convinced most MSCPA members that the DOR is working contrary to public interest. It is obvious to most CPAs that DOR's mission is to collect the *maximum tax* from taxpayers, not necessarily the *correct tax*.

The episode we experienced with the DOR regarding the tax benefit rule is one example of tax maximization. Another example is the invocation of penalties on taxpayers who amend a prior year return. We appreciate DOR's administrative rule change which allows for a waiver of penalties. However, this should be an automatic process – not something taxpayers must apply for. In addition, the notices going out to taxpayers do not mention the waiver process so a taxpayer is at a disadvantage if they do not have someone to advise them of the waiver.

Perhaps the strongest evidence of the new direction of DOR is the legislative focus. Our observation has been that this focus is to the detriment of tax administration. The fact that 25 bills were requested by DOR in the last session indicates the center of attention lies exclusively in the legislative arena.

A casualty of the legislative focus was the MSCPA State Taxation Committee's 2006 liaison meeting with DOR. This joint meeting has been held annually to review tax form drafts and to discuss tax processing and filing issues. It has produced many positive outcomes over the years. Although we can't guarantee it, we feel if we had been able to have the 2006 meeting we may have been able to discover the problem with the itemized deduction forms regarding the phase out of the limitation on high income taxpayers. Hundreds, perhaps thousands of tax returns, are potentially impacted by the incorrect form.

Compounding the problem is the poor communications sent to the taxpayer explaining the itemized deduction changes. The initial letters said the taxpayer would owe more tax, even when they didn't. The analysis of the tax return and the changes the letter proposed are not understandable to the average taxpayer. We can't help but wonder how many incorrect letters were received by taxpayers.

The inferior quality of letters and explanations sent to taxpayers results in more people turning to their tax preparers. Typically taxpayers will contact their CPA and provide them a copy of the communication received from the DOR. However, it is common for taxpayers to assume the tax preparer did something wrong, or worse, that the taxpayers themselves did something incorrect. The result in either scenario is that tax preparers need to console their clients and reassure them they are not going to jail.

The communications often lack detail and explanations addressing the source of proposed changes, lack detail regarding payments made on behalf of taxpayers and the tone is often accusatory.

The computer generated letters from DOR are becoming more numerous and more threatening to taxpayers. Some taxpayers are intimidated just receiving such notices from the State or Federal government and they pay the tax whether they actually owe it or not. We do not believe this is good tax policy.

### **CONCLUSION**

We want what is best for Montana's taxpaying citizens. We favor a system that is simple and fair, easy for taxpayers to understand and simple for taxpayers to comply with. It is our hope that this letter can reopen some very valuable lines of communications between our two organizations. As a group that works with taxpayers, the laws and regulations of state income taxation and the Department of Revenue, we have knowledge and experience that can be helpful. We would welcome the opportunity to discuss these issues with the Governor, Department of Revenue representatives and anyone interested in the issues outlined in this paper.

*The Montana Society of CPAs is a voluntary membership association for certified public accountants. Responses to this paper may be addressed to: Montana Society of CPAs, State Taxation and Legislation Committees, PO Box 138, Helena, MT 59624.*